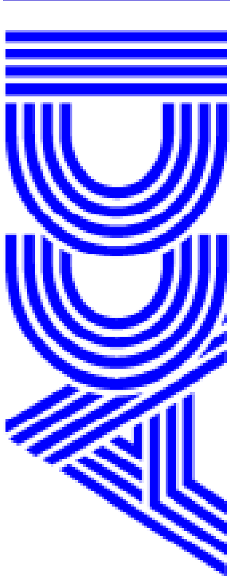


AUSTRALIAN CHAMBER OF COMMERCE AND INDUSTRY

# HARMFUL TAXATION COMPETITION

**Tax competition is on the active agenda for the Organisation for Economic Co-operation and Development (OECD). While much of the OECD's research and analysis has contributed to more efficient and competitive governments, its work on what it claims to be harmful tax competition could well impugn the sovereignty of nations, and undermine the capacity of international business to pursue commercial opportunities.**

The OECD's work on harmful tax competition is a barely-disguised effort to limit, if not eliminate, tax competition between countries, and to place a minimum platform under the taxation systems of developed countries.

In short, the OECD is putting in place a framework which could potentially see global tax rates lifted up to the levels of higher spending governments, or least efficient tax administrations.

This levelling-up objective is underscored in OECD media statements which point out its work on potentially harmful tax competition 'is about ensuring that the burden of taxation is fairly shared …' and 'governments must take measures, in particular intensifying their international co-operation … to protect their tax bases.'.

Rather than engage in business-bashing for their legitimate use of taxation systems implemented by sovereign nations, the OECD could usefully reinforce to member governments the adverse effects of excessive spending and inefficient tax administrations which, in turn, stimulate business interest in global tax competition.

If national governments are concerned about the potential loss of revenue from tax competition then the more appropriate approach would be to examine the burdens imposed by their tax systems – tax rates which are too high, and/or the tax administrations which are inefficient and impose excessive compliance costs on taxpayers.
Similarly, if governments are concerned at the loss of income tax revenue because of their uncompetitive tax systems, an alternate and more productive approach may be to move toward consumption tax-style systems.

Of course, they could also reduce and reform public sector expenditure; lesser spending means lesser taxation.

## OECD and Tax Competition

The primary motivation for the OECD's work on 'harmful' tax competition is to reduce the nature and extent of effective tax competition between national governments.

Commerce House, 24 Brisbane Ave, Barton ACT 2600 • PO Box E14, Kingston ACT 2604 Australia
**Telephone:** 61-2-6273 2311 • **Facsimile:** 61-2-6273 3286 • **Email:** acci@acci.asn.au • **ACN** 008 391 795

According to one OECD document: 'If nothing is done, governments may increasingly be forced to engage in competitive tax bidding to attract or retain mobile activities.'

In effect, the OECD's work is about, at very least, limiting and potentially eliminating tax competition between governments. In short, governments practising the sort of collusion they generally prohibit in their own competition law regimes.

The underlying assumption of the OECD work is tax competition is a bad thing. For high spending/taxing, inefficient governments it would be a anathema; for those with more appropriate spending/taxing, and efficient regimes, tax competition would be an opportunity to accelerate and broaden their economic and commercial growth and development.
As with the trade and investment liberalisation under the World Trade Organisation, so the capacity of sovereign governments to realise their competitive advantages in taxation would also add to growth and development.

Looked at another way, if governments support more liberal competition in trade and investment, why should they not similarly support comparable arrangements in taxation, unless, of course, they have double standards?

Commerce and industry supports tax competition which delivers more efficient tax administration and regimes, with sovereign governments free to choose their own spending and taxing arrangements.

Quite simply, sovereign governments could choose to be a higher spending/taxing country with less efficient tax administrations, or a lower spending/taxing one with more efficient administrations.

Many of these concerns are being echoed by sovereign national governments.

A formal statement by Finance Ministers from British Commonwealth countries (which includes OECD members such as Australia, Britain and Canada) in September this year 'recognised that tax competition could in fact be helpful, and not harmful, because it can further spur governments to create fiscal environments conducive to generating growth and employment.'

They also reaffirmed 'the right of member countries to compete in international financial markets, through the provision of both domestic and international financial services' and 'the right of sovereign nations to determine their own tax policies.'

The World Bank, the International Monetary Fund and the United Nations system have comparable concerns over the implications for developing countries of the OECD's work on tax competition.

Another, flawed assumption which underpins the OECD's assault on tax competition is decisions on foreign activity and investment are driven overwhelmingly by taxation factors. Such an attitude is at best blinkered and ill-informed.

While taxation is quite rationally taken into account in many foreign activity and investment decision-making processes, it generally ranks well below more fundamental commercial considerations.

These include access to essential inputs and vital markets, adequacy of infrastructure (especially communications and transport systems), political and social stability, and the presence and effectiveness of the rule of law.

The Business and Industry Advisory Committee to the OECD (of which the Chamber is the Australian national member) put it well when it said in its own critique of the OECD's work on harmful tax competition:

> 'The multinational enterprises that utilise the environments offered by the tax havens or countries with preferential tax regimes have **not** [their emphasis], in general, done so primarily for tax saving reasons, but because these locations have developed an expertise in servicing such activities which, today, are far more significant than tax benefits in attracting business.'

For many of the developing countries that offer preferential tax regimes, they are rationally seeking to build upon their comparative advantages as relatively lower spending and taxing sovereign nations, and often attempting to develop global competitive advantage in providing international financial services.

By offering competitive taxation systems, one part of which is a lower tax burden, these developing countries are seeking to fund their own economic growth and development, often where they have few alternatives (beyond tourism and subsistence aquaculture).

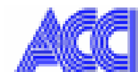
In essence, they are offering what many industrialised countries are unable, or unwilling, to provide – efficient, low-burden taxation systems – the revenue from which will finance their own economic futures.

### 'Harmful' Tax Competition

The OECD work on what it considers harmful and preferential tax arrangements is founded in two studies: 'Harmful Tax Competition: An Emerging Global Issue', released in April 1998; and, 'Progress in Identifying and Eliminating Harmful Tax Practices', issued in June this year.
Further studies are expected to include a 'List of Unco-operative Tax Havens', (ostensibly a black list of sovereign nations unwilling to submit to OECD pressure) to be published in June 2001, and work on the application of withholding taxes and transfer pricing rules to countries with preferential tax regimes.

Two important products of the 1998 study were the promulgation by the OECD of a set of 'Guidelines for Dealing with Harmful Preferential Regimes in Member Countries', and a series of Recommendations for combating harmful tax practices in member and non-member countries.

Under the Guidelines, OECD member countries, which includes Australia, have committed to standstill and rollback provisions on harmful tax practices. That is, they will: not adopt



new measures, or extend or strengthen existing measures, which constitute harmful tax practices; and, eliminate the harmful features of preferential regimes within five years.

The Recommendations focus attention on determining whether a nation constitutes a tax haven (for example, do they have low or no nominal effective tax rates, the nature and extent of transparency in their laws, arrangements for the exchange of information, and requirements for the presence of substantial activities), and what countervailing action OECD governments should take.

To its credit, the OECD's work does not regard 'harmful' tax competition to be the exclusive province of smaller, developing countries.
The 30-odd OECD member countries themselves make available some 47 categories of preferential tax rules which potentially breach OECD guidelines on harmful tax competition.

In Australia's case, these are our Offshore Banking Units laws, with other OECD member countries cited for preferential tax arrangements in areas such as insurance, banking, funds management, headquarters, distribution and service centres, and sea transport.

Against this background, a higher priority for the OECD would be to have member countries show leadership by moving decisively on their own potentially harmful preferential tax arrangements, rather than coercing developing countries on their tax competitive arrangements.

Any failure by OECD countries to do so would provide a clear window into their true motivation for their pressing ahead with efforts to quash anti-tax competition arrangements in other sovereign nations.

Practical experience suggests, however, the developed countries are unlikely to show the necessary leadership, preferring instead to export the burden and pain of adjustment on to the developing countries; those often least able to afford it.

This tendency is underscored in another disturbing characteristic of the OECD's work on tax competition and preferential tax regimes – the implied intimidation which appears intent on coercing compliance by small, sovereign countries.
As the OECD stated in a media release issued in June this year, it is

> 'developing a general framework within which member countries can implement a common approach to tackling harmful tax competition. This will include defensive measures that countries will consider applying to unco-operative tax havens that choose not to commit to eliminate harmful tax practices.'

In short, those sovereign nations who do not submit to the arrangements to be imposed by OECD member countries will suffer penalties to be determined and meted out by those nations.